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Inside the 'funky' history of Groupon's biggest shareholder

Remember The New Economy? You better

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A decade before he helped found Groupon – the online daily-deals site that turned so many heads last week when it filed for an IPO valuing itself at $30bn – Eric Lefkofsky ran a startup called Starbelly.com.

In the lingo of the day, the Chicago-based Starbelly was billed as a "B2B" outfit, offering a marketplace where businesses could arrange to distribute promotional goods. In 2000, the company sold itself to old-school brick-and-mortar retailer Ha-Lo for $240 million.

Starbelly officers assumed lead positions within Ha-Lo – Lefkofsky was chief operating officier – and a little more than a year later, the company went bankrupt. Ha-Lo and Starbelly faced multiple class-action fraud lawsuits from shareholders, and one suit, which was eventually settled, turned up emails Lefkofsky had sent to his colleagues.

"lets start having fun ... lets get funky ... lets announce everything ... lets be WILDLY positive in our forecasts ... lets take this thing to the extreme ... if we get wacked on the ride down – who gives a shit ... THE TIME TO GET RADICAL IS NOW ... WE HAVE NOTHING TO LOSE...," he said in one email, according to court documents.

Ten years on, as Groupon seeks an IPO, this email keeps popping up. *The Financial Times* alluded to it in a piece last week, and it has now turned up in reports from *Bloomberg TV* (YouTube video) and *Fortune*.

The email was echoed – at least in small part – by statements Lefkofsky made last week that seemed to break the SEC's "quiet period" rule for IPOs.

'These are not sham companies. These are great businesses'

"I'm going to be in technology for a long time," Lefkofsky told *Bloomberg* on June 3 – a day after Groupon filed for an IPO – going on to refer to two other companies he founded, InnnerWorkings and Echo. "I'm going to start a lot of companies. These are not sham companies. These are great businesses. InnerWorkings is profitable. Echo is profitable. Groupon is going to be wildly profitable."

Because Lefkofsky used such language during the quiet period, Groupon may be forced to re-file for its IPO. But separately, some have raised concerns over the similarity between the statement and that decade-old email – and, more generally, over the lawsuit-ridden business history of Lefkofsky and his old college buddy Brad Keywell, who co-founded Starbelly.com. Lefkosky, Groupon's chairman, owns a nearly 22 per cent pre-IPO stake in the company. Keywell owns a seven per cent stake.

Lefkofsky's email is very much indicative of its time. in those days, many tech entrepreneurs were no doubt saying much the same thing. And yes, lawsuits are an unavoidable part of doing business in the modern world.

But Mark Morgenstern, managing partner of San Francisco-based investment firm Blue Mesa Partners – and who is also a lawyer – tells *The Register* that potential Groupon investors should at least consider the business history of the company's founders.

Eric Lefkofsky

"If I were an underwriter or a buyer of security, [Lefkosky's past] would strike a word of caution," he says. "I would say 'This may be a very talented guy, but does he really grasp what being a CEO post–Sarbanes-Oxley means?' This might give you some pause, but it's not a show stopper. You would still evaluate the [entire] guy and the job he's doing and the company – but [the history] would be something you take into the mix to consider."

Groupon did not respond to requests for comments on Lefkofsky's business history, and Lefskosky's lawyer, Charles Sipkins, declined to comment.

> “lets get funky ... lets announce everything ... lets be WILDLY positive in our forecasts ... lets take this thing to the extreme ... if we get wacked on the ride down – who gives a shit.” —Eric Lefkofsky during the last dot.com bubble

After Ha-Lo and Starbelly filled for bankruptcy, the companies faced multiple lawsuits from shareholders, including one that named Lefkosky and Keywell as defendants.

According to a notice sent to anyone who purchased stock in Ha-Lo over a roughly two-year period starting in 1999, the suit alleged that Ha-Lo's top officers and directors "knowingly, or at least recklessly, made grossly inaccurate statements concerning its agreement to acquire Starbelly.com", and that they "repeatedly highlighted the extraordinary benefits of the acquisition" although it led, at least in part, to Ha-Lo's bankruptcy.

It's worth remembering that anyone can file a lawsuit. "We live in a relatively binary world: something either succeeds or it fails," says Morgenstern. "This is a world in which everyone wants to put a Scarlet Letter F for failure on everyone and turn them into Hester Prynne. If there is a problem, somebody sues. Any time you see an earnings release that's different from what's expected, somebody sues. You consider everything about a person when considering investing in them, but ... every case does truly need to stand on its own facts."

But there are more than a few lawsuits in Lefkofsky's past. Before founding Starbelly, Lefkofsky and Keywell purchased a children's athletic-clothing company called Brandon Apparel. On his personal blog, Lefkofsky called Brandon a "huge failure. We over-leveraged the company and it eventually crumbled under the weight of that debt when the industry began to consolidate against us."

After the company entered bankruptcy, there was a lawsuit from the company's bank, according to a 2007 story from *Barron's*, and in this suit, the bankers alleged that Lefkofsky used Brandon Apparel's resources to start Starbelly and defrauded creditors by preventing them from recouping loans from the dot.com. Brandon was also sued by National Football League Properties, Major League Baseball Properties, and the former owner of Brandon.

Funky déjà vu

The class-action fraud suits against Ha-Lo and Starbelly were eventually settled. Lefkofsky's email urging colleagues to "get funky" was first turned up by that *Barron's* story, which concerned his subsequent venture: InnerWorkings. As *Fortune* points out, the *Barron's* piece raised many of the same concerns with InnerWorkings that are now being raised with Groupon, and it claimed that InnerWorkings has tried to hide Lefskofsky's involvement.

"InnerWorkings goes to great lengths to obscure its ownership and control by a chap named Eric P. Lefkofsky who has a history of busting investors after promising to radically transform bricks-and-mortar industries," the story said. "The current InnerWorkings road show and stock-offering is, in part, aimed at cashing out much of Lefkofsky's stock while InnerWorkings shares teeter at stilted levels."

At one point, InnerWorkings was sued by a company called Sports Publishing LLC. The suit accused Lefkofsky of billing Sports Publishing hundreds of times for fraudulent amounts from 2005 to 2007 and of "terrorist tactics to distract the company". "All of these illegal activities were intended to and did deflect Sports Publishing away from the massive fraud Lefkofsky and the Defendants were engaged in," the suit alleged. The suit was later withdrawn, and InnerWorklngs countersued.

$382 million pocketed. Before the IPO

Others have raised concerns over the Groupon IPO because Lefkofsky and his family have already received $382 million from Groupon – prior to the IPO filing. Similarly, Keywell and his family received $156 million, and thirty-year-old CEO Andrew Mason received $10 million. As *AllThingsD* points out, Groupon has raised $946 million, and $810 million was paid out to employees and investors as stock purchases.

According to its SEC filing, Groupon's revenues have soared of late, but the company is still very much in the red. Its revenues topped $644.7m in the first quarter of 2011, up from $44.2m in the same quarter last year, but its losses reached $102.7 million as the company spent heavily on sales staff and marketing.

Groupon – which sells coupons for discounted goods and services from local merchants – has found a niche where it could bring in large sums of money in a very short amount of time. But it's yet to be seen whether the business is sustainable in the long term. Some Groupon customers have started to complain that the coupon service is not a viable way for them to improve to their own sales.

Many, particularly in the tech press, have been strangely positive about Groupon's prospects. The company became a kind of cause célèbre after it apparently rejected a $6bn acquisition from Google. The IPO filing puts its value significantly higher: an astounding $30bn. The next wave of massive IPOs is well and truly upon us. In addition to Groupon's filing, LinkedIn has already gone public, and Pandora has filed, as well. But as this wave hits, let's not forget the last one. "Wild positivity" takes a company only so far. ®